

**Report of the Second Supplemental Investigation  
of the  
Special Demand Committee**

**Board of Directors of Cardinal Health, Inc.**

**October 28, 2014**

***Confidential  
For Committee Use Only***

## TABLE OF CONTENTS

EXECUTIVE SUMMARY .....	1
REPORT OF THE SPECIAL DEMAND COMMITTEE.....	3
I. The Demand.....	3
A. The Prior Demands .....	3
B. The Current Demand.....	3
II. Relevant Legal Standards .....	4
III. The Investigation .....	4
IV. Recommendations on Merits of Allegations.....	5
CONCLUSION.....	5

## EXECUTIVE SUMMARY

In May 2014, the Board of Directors (the “Board”) of Cardinal Health, Inc. (“Cardinal Health” or the “Company”) received a third shareholder demand from Erste-Sparinvest Kapitalanlagegesellschaft m.b.H. (“Erste-Sparinvest”). Before this demand (the “Erste-Sparinvest Demand”), the Company received two shareholder demands. The first demand was a letter sent on behalf of Isabelle Rauch in September 2012 (the “Rauch Demand”), demanding that the Company initiate an action against twenty-two present and former directors for breach of fiduciary duty relating to the 2012 Immediate Suspension Order (the “2012 ISO”) issued by the Drug Enforcement Agency (“DEA”) regarding the Company’s Lakeland, Florida distribution center. The second demand was a letter and follow-up letter sent on behalf of Henry Stanley, Jr. in September 2013 (the “September Stanley Letter”) and October 2013 (the “October Stanley Letter” and, together with the September Stanley Letter, the “Stanley Demand”), demanding that the Company initiate an action against the same twenty-two directors for allegations contained in a complaint filed in the case of *Stanley v. Arnold*, No. 1:12-cv-00482 (S.D. Ohio June 22, 2012) (the “Stanley Complaint”) and that the Special Committee investigate three issues: (1) the Company’s December 2006 settlement of an action brought by the Attorney General’s Office of the State of New York (the “NY AG Action” and the “NY AG Settlement”); (2) the Company’s “ultimate settlement” that it reached with the DEA in 2008 (the “2008 MOA”) and any ensuing compliance efforts; and (3) the Company’s purported failure to report suspicious orders in West Virginia, as alleged in a complaint filed in June 2012 by the Attorney General for West Virginia (the “West Virginia Action”).

The Board convened a Special Committee (the “Committee”) in November 2012 to investigate the allegations contained in the Rauch and Stanley Demands, and the Committee submitted reports and recommendations to the Board in April 2013 (the “Original Report”) and January 2014 (the “Supplemental Report”). The Original Report concluded that the Company had implemented a rigorous system for preventing diversion in the years leading up to the 2012 ISO, and that the Board and Audit Committee received regular updates regarding the anti-diversion system and there were no “red flags” that the system was inadequate. Accordingly, the Original Report recommended that the Company not pursue the action contemplated by the Rauch Demand. The Board adopted the recommendations of the Original Report in May 2013. The Supplemental Report concluded that the allegations contained in the Stanley Demand and Complaint were similar to those asserted in the Rauch Demand and thus were the subject of the previous investigation and the Original Report. The Supplemental Report also detailed the Committee’s investigation of the three additional issues raised by the October Stanley Letter. In the Supplemental Report, the Committee concluded that its original recommendations with respect to the Rauch Demand applied with equal force to the Stanley Demand and therefore the Committee concluded that it was not in the best interests of the Company to pursue the action contemplated by the Stanley Demand. The Board adopted the recommendations of the Supplemental Report in February 2014.

The Erste-Sparinvest Demand is nearly identical to the Stanley Demand and relies on the exact same allegations and issues asserted in that demand, and Erste-Sparinvest is represented by the same counsel as Stanley. Thus, the Special Committee’s previous investigations and reports thoroughly encompass the matters raised in the Erste-Sparinvest Demand. However, out of an abundance of caution, the Special Committee conducted an additional investigation into recent

developments in the West Virginia Action, as that is the only issue raised in the Erste-Sparinvest Demand that remains ongoing and was nascent at the time the Committee conducted its previous investigations.

After additional investigation, the Committee concludes that there is nothing raised by the current demand that would alter its findings and conclusions from the previous Rauch and Stanley Demands. For the foregoing reasons, and as set forth fully in the Original Report and Supplemental Report and the ensuing report (the “Second Supplemental Report”), the Committee recommends that the Board reject the Erste-Sparinvest Demand.

## **REPORT OF THE SPECIAL DEMAND COMMITTEE**

### **I. THE DEMAND**

On May 6, 2014, counsel for shareholder Erste-Sparinvest sent a letter purporting to be a shareholder demand on the Company's Board. The Erste-Sparinvest Demand attaches a copy of the Stanley Complaint that was filed on behalf of Henry Stanley, Jr. in June 2012<sup>1</sup> and demands that the Board "immediately investigate and commence legal action for remedial and other relief" against twenty-two Cardinal Health directors (the "Director Defendants"). (Erste-Sparinvest Demand at 1.) The Erste-Sparinvest Demand alleges that the Director Defendants violated their fiduciary duties in connection with the allegations contained in the Stanley Complaint<sup>2</sup> and, as a result, the Company suffered "substantial financial injuries." (*Id.*) In addition, the Erste-Sparinvest Demand states that "other facts not specifically alleged in the *Stanley* litigation [that] have also come to light reflecting potential misconduct by the Director Defendants." (*Id.*) These "facts" refer to three issues concerning: (1) the Company's NY AG Settlement; (2) the Company's "ultimate settlement" that it reached with the DEA in 2008 (i.e., the 2008 MOA) and any ensuing compliance efforts; and (3) the Company's purported failure to report suspicious orders in West Virginia, as alleged in a complaint filed by the Attorney General for West Virginia. (*Id.* at 1-3.) The Committee believes that the two prior investigations it conducted, and the corresponding reports memorializing those investigations and findings, fully encompass the Erste-Sparinvest Demand allegations and therefore the conclusions of each of the prior Committee reports apply with equal force to the Erste-Sparinvest Demand.

#### **A. The Prior Demands**

The Company has received two prior shareholder demands that bear directly on the Erste-Sparinvest Demand and the Committee's investigation. The first demand was the Rauch Demand dated September 28, 2012. The second demand was the Stanley Demand, comprised of letters dated September 5, 2013 and October 23, 2013. These demands are described in greater detail in the Committee's earlier reports to the Board: the Original Report, dated April 12, 2013, and the Supplemental Report, dated February 4, 2014.<sup>3</sup>

#### **B. The Current Demand**

The Erste-Sparinvest Demand is nearly identical to the Stanley Demand. It demands that the Company "immediately investigate and commence legal action for remedial and other relief"

---

<sup>1</sup> The Stanley Complaint was originally attached as an exhibit to a shareholder demand dated September 5, 2013, sent to the Company by counsel for shareholder Henry Stanley, Jr. That letter demanded that the Board investigate and commence legal action regarding the Stanley Complaint's allegations. (Stanley Demand at 1, Exhibit A.)

<sup>2</sup> One month prior to the September 5, 2013 Stanley letter, the Sixth Circuit Court of Appeals issued a decision affirming a lower court's dismissal of the Stanley Complaint, finding that Stanley failed to "state with particularity" the reasons for his failure to make a pre-suit demand on the Board to investigate the Complaint's allegations. *See Stanley v. Arnold*, 531 F. App'x 695, 695 (6th Cir. 2013).

<sup>3</sup> For reference, the Erste-Sparinvest Demand, the Rauch Demand, the September Stanley Letter and Stanley Complaint, the October Stanley Letter, the Original Report, and the Supplemental Report are included in an appendix to this report.

against the same Director Defendants named in the Stanley Demand for allegedly “violating their fiduciary duties in connection with the allegations contained in the [Stanley Complaint].” (Erste-Sparinvest Demand at 1.) The Erste-Sparinvest Demand also requests that the Company investigate the identical three issues previously raised in the October Stanley Letter (i.e., the NY AG Settlement, the 2008 MOA with the DEA, and the West Virginia Action.) (*Id.* at 1-3.) Indeed, the only textual difference of note is that the October Stanley Letter refers to these three issues as “additional material facts not included in the pleadings that we believe the Special Committee should investigate” (October Stanley Letter at 2), whereas the Erste-Sparinvest Demand refers to them as “other facts not specifically alleged in the *Stanley* litigation [that] have also come to light reflecting potential misconduct by the Director Defendants.” (Erste-Sparinvest Demand at 1.) The Committee believes that this textual variation does not alter the scope of the Erste-Sparinvest Demand investigation. Indeed, Erste-Sparinvest’s own counsel acknowledges the similarity of the two demands noting that a “similar demand was made by Henry Stanley, Jr.” and asks that he be notified if the Company plans to “reject this new demand on the same grounds as Stanley’s demand.” (*Id.* at 3.)

## II. RELEVANT LEGAL STANDARDS

As discussed in the Original Report and the Supplemental Report, Ohio law provides that “[a] director shall be liable in damages . . . only if it is proved by clear and convincing evidence . . . that the director’s action or failure to act involved an act or omission undertaken with deliberate intent to cause injury to the corporation or undertaken with reckless disregard for the best interests of the corporation.” Ohio Rev. Code § 1701.59(E); *see also* Original Report at 5; Supplemental Report at 6-7. Directors satisfy their obligation to remain informed of the corporation’s activities if an information and reporting system exists within the company that will provide senior management and the directors with accurate and timely information “sufficient to allow . . . informed judgments concerning . . . the corporation’s compliance with [the] law . . . .” *In re Caremark Int’l Inc. Deriv. Litig.*, 698 A.2d 959, 970-71 (Del. Ch. 1996). Where a reporting system exists, “[d]irectors will be potentially liable for breach of their oversight duty only if they ignore ‘red flags’ that actually come to their attention, warning of compliance problems.” *Stanley v. Arnold*, No. 1:12-CV-482, 2012 WL 5269147, at \*6 (S.D. Ohio Oct. 23, 2012) (quoting *Forsythe v. CIBC Emp. Private Equity Fund*, No. 657-N, 2006 Del. Ch. LEXIS 60, at \*7 (Del. Ch. Mar. 22, 2006)).

## III. THE INVESTIGATION

The Committee concludes that the investigations it conducted in response to the prior Rauch and Stanley Demands fully encompass the subject matter of the allegations contained in the Erste-Sparinvest Demand. The prior investigations were thorough and ultimately concluded that the Board at all times acted diligently and in good faith to fulfill its duties to the Company. These investigations are described in greater detail in the Committee’s Original Report and Supplemental Report.

Because the third issue identified by the Erste-Sparinvest Demand (i.e., the West Virginia Action) is still ongoing, and out of an abundance of caution, the Committee reviewed materials filed subsequent to the Supplemental Report. The original complaint was filed on June 26, 2012. On January 8, 2014, the West Virginia Attorney General filed an amended complaint (the “West

Virginia Amended Complaint”). A review of the West Virginia Amended Complaint did not reveal any additional allegations or developments that would require the Committee to alter the scope of the Erste-Sparinvest Demand investigation or affect the conclusions of its prior investigations. Instead, the West Virginia Amended Complaint merely asserts additional factual allegations relating to the 2012 ISO (which, for reasons discussed *supra* have already been investigated by the Committee). (*See generally* Amended Complaint, *State ex rel. Morrissey v. Cardinal Health, Inc.*, No. 12-C-140 (W. Va. Cir. Ct., filed Jan. 8, 2014).) Since the filing of the West Virginia Action in 2012, the Board and Audit Committee continue to receive regular updates on the status of the lawsuit.

#### **IV. RECOMMENDATIONS ON MERITS OF ALLEGATIONS**

The Board is responsible for ensuring that an information and reporting system is in place such that the Board will receive sufficient information to make informed judgments regarding the Company’s compliance with its legal obligations. *See supra* Part II; *Caremark*, 698 A.2d at 970-71. The Committee finds that all of the issues and allegations raised in the Erste-Sparinvest Demand were thoroughly investigated as part of its prior Rauch and Stanley Demand investigations. The Original Report and Supplemental Report concluded that the Company implemented a rigorous system for preventing diversion and reporting suspicious orders, that the Board received regular updates regarding the system, and at no time did the Board fail to act in the face of any red flags that the Company’s anti-diversion controls were inadequate. (Original Report at 36-39; Supplemental Report at 8-14.) Nothing in the Erste-Sparinvest Demand remotely calls into question the findings and conclusions of the Committee’s prior investigations and the Committee reaffirms those findings and conclusions here. Because those findings and conclusions are entirely applicable to the Erste-Sparinvest Demand, the Company cannot recover monetary damages from any past or present directors and should not pursue the action contemplated by the current Demand.

Regarding the West Virginia Action, the allegations contained in the original and amended complaints were the subject of the Committee’s previous investigations and the Original and Supplemental Reports, and the conclusions of those reports apply with equal force to the original and amended complaints. Because the West Virginia Action is still pending, the implications of its outcome for the Company are still unknown. However, as with the open issue of possible civil payments by the Company to the federal authorities, further allegations made in or the ultimate resolution of the West Virginia Action would not change the Committee’s conclusions. The Committee’s prior demand investigations have thoroughly probed the directors’ knowledge and conduct regarding the Company’s distribution of controlled substances in general, not excluding the Company’s activities in West Virginia. The Committee’s determination that there is no sound basis for finding liability on the part of the Director Defendants is independent of and would not be influenced by whether the state of West Virginia ultimately obtains any relief from the Company.

#### **CONCLUSION**

For the foregoing reasons, the Committee recommends that the Company not pursue the legal action requested by the Erste-Sparinvest Demand and should reject the demand made on the Board.